

BUSINESS VALUATION METHODS

I. Adjusted Book Value

Take the Book Value of net worth
- (minus) assets not acquired
+ liabilities not assumed
+ fair market value of assets acquired
+ any net worth adjustments
= **Adjusted Book Value**

II. Gross Revenue Multiplier

Example:
Last Year's Sales x Multiplier

III. Capitalized Adjusted Earnings

First Step: Adjust Historical Earnings

	<u>Last year</u>
Net Profit	50.0
+ Officer's salary	+ 70.0
+ Discretionary expenses	+ 30.0
- New Owner salary	- 60.0
Adjusted Profit	90.0

Second Step: Get the adjusted profits for 5 years, then do a Weighted Average of the Adjusted Earnings

<u>Year</u>	<u>Earnings</u>	<u>Weight</u>	<u>Adjusted</u>
2000	\$ 50	1	\$ 50
2001	\$ 30	2	\$ 60
2002	\$ 70	3	\$ 210
2003	\$ 60	4	\$ 240
2004	\$ 90	5	\$ 450
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	Totals	15	\$ 1,010
			Divided by 15 =
			Average of \$ 67
			(rounded)

Third Step: Calculate a Discount Rate

	<u>Example</u>
Determine the T-Bill Rate	5.0%
Determine the Offset Risk Rate	12.0%
-- Establish rate of return based on risk factors	
-- Establish rate of return based on general economy	
Determine Offset Illiquidity Rate	3.0%

Fourth Step: Take the weighted average of the Adjusted Earnings and divide by the Discount Rate

Example: $\$67/.20 = \335

IV. Discounted Future Earnings

First Step: Adjust Historical Earnings

	<u>Last year</u>
Net Profit	50.0
+ Officer's salary	+ 70.0
+ Discretionary expenses	+ 30.0
- New Owner salary	- 60.0
Adjusted Profit	90.0

Second Step: Get the adjusted profits for 5 years, then do a Weighted Average of the Adjusted Earnings

<u>Year</u>	<u>Earnings</u>	<u>Weight</u>	<u>Adjusted</u>
2000	\$ 50	1	\$ 50
2001	\$ 30	2	\$ 60
2002	\$ 70	3	\$ 210
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	Totals	15	\$ 1,010
			Divided by 15 =
			Average of \$ 67
			(rounded)

Third Step: Determine the Discount Rate

	<u>Example</u>
Determine the T-Bill Rate	7.0%
Determine the Offset Risk Rate	12.0%
-- Establish rate of return based on risk factors	
-- Establish rate of return based on general economy	
Determine Offset Illiquidity Rate	6.0%
Total the Rates:	25.0%

Fourth Step: Estimate growth, both real and inflationary (for this example, we are estimating a 5% growth rate).

Fifth Step: Multiply the estimated earnings for each year by the estimated growth rate until estimated earnings for the next **ten** years are determined.

Sixth Step: Multiply the adjusted, weighted earnings by the estimated growth (1 plus the growth rate) to determine the estimated earnings for the first year.

Seventh Step: Using the net present value table, multiply the estimated earnings for each year by the factor for the discount rate for each respective year to determine the discounted value of future earnings.

Eighth Step: Total the discounted earnings.

Ninth Step: Determine the residual value by subtracting the growth rate from the discount rate and dividing the difference into the discounted earnings for year ten.

Tenth Step: Add the residual value to the total discounted earnings.

Year	Previous Yr. Earnings	Growth (1 + 5%)	Adjusted Earnings	Factor (25%)	Net Present Value
1	67.0	1.05	70.4	0.80000	56.3
2	70.4	1.05	73.9	0.64000	47.3
3	73.9	1.05	77.6	0.51200	39.7
4	77.6	1.05	81.5	0.40960	33.4
5	81.5	1.05	85.6	0.32768	28.0
6	85.6	1.05	89.9	0.26214	23.6
7	89.9	1.05	94.4	0.20972	19.8
8	94.4	1.05	99.1	0.16777	16.6
9	99.1	1.05	104.1	0.13422	14.0
10	104.1	1.05	109.3	0.10737	11.7
Net Total					290.4
Residual					58.5
Total					348.9

V. Cash Flow Method

First Step: Identify available cash for debt service via rule of thumb, Sources/uses, or any other acceptable method.

	<u>Last year</u>
Net Profit	10.0
+ Depreciation	5.0
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Adjusted Profit	15.0

Second Step: Choose a reasonable maturity and market interest rate for the financing requested.

	<u>Years</u>
Fixed Asset Purchases	10
Working Capital	7
<u>Average Maturity</u>	<u>8.5</u>
<u>Interest Rate</u>	<u>12%</u>

Third Step: Reverse-compute the amount of total funds that the cash flow can support given the maturity and interest rate chosen (using an amortization table or calculator).

Cash flow of \$15,000 annually at 12% for 8.5 years is annual debt service for the total amount of \$79,696.69 (computed on an annual payment basis) or \$77,295.78 (computed on a monthly payment basis).

Cash flow valuation establishes a range of \$77,000 to \$80,000.